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Intelligence Memorandum

India: Economic Performance In 1970 And Short-Term Prospects

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
July 1971

INTELLIGENCE MEMORANDUM

INDIA: ECONOMIC PERFORMANCE IN 1970 AND SHORT-TERM PROSPECTS

Introduction

1. India's economic growth record has improved in recent years, primarily as a result of four consecutive years of good crop weather. Industrialization has lagged, however, mainly because of government restrictions on industrial imports and on private investors. In addition, conservative fiscal policies have restrained government development spending in the almost exclusively heavy industry public sector and thereby reduced the demand for the products of a host of supporting industries.

2. The slow import growth during 1970, combined with some success in India's export drive, has improved India's international financial position. This gives Mrs. Gandhi an opportunity to liberalize import restrictions without jeopardizing the nation's international financial position in the short run. This memorandum reviews India's economic performance in 1970 and evaluates Mrs. Gandhi's policy options with respect to accelerating industrial growth.

Discussion

Economic Performance in 1970

3. India's national income increased by 5% in 1970, 1/ spearheaded by a similar increase in foodgrain production (see Table 1). Four

1. Unless otherwise indicated, years given throughout this memorandum are fiscal years, which begin on 1 April of the stated year.

Note: This memorandum was prepared by the Office of Economic Research and coordinated within the Directorate of Intelligence.

Table 1

India: Growth Rates of National Income and Selected Sectors of the Economy

Percent

	1961-68 Average a/	1969	1970
National income b/	3.0	5.3	5.0
Agriculture c/	1.4	5.6	5.0
Foodgrains	1.7	5.7	5.5
Commercial crops	0.7	5.4	2.0
Industry d/	6.1	7.1	4.7
Basic industries	6.1	8.9	4.3
Iron and steel	8.0	8.5	-6.5
Mining and quarrying	4.7	2.2	4.1
Capital goods	9.7	1.8	3.5
Industrial machinery	5.2	-12.7	0
Railroad equipment	3.4	-10.6	-14.8
Intermediate goods	5.0	4.2	4.7
Cotton yarn	2.2	-1.1	5.7
Consumer goods	2.5	10.2	5.9
Cotton cloth	-0.5	-4.9	2.5
Drugs and pharmaceuticals	5.6	1.5	0
Consumer durables	9.9	12.9	0.4

a. The base year is 1960.
b. Fiscal years.
c. Crop years.
d. Calendar years for 1960-69. Data for 1970 compare the January-August period with the comparable period in 1969. Industry's growth rate for all of 1970 was about 5%.

consecutive years of good weather and government policies favoring foodgrain production have greatly improved India's food position. Preliminary estimates indicate that foodgrain output in the 1970 crop year (CY) 2/ will top 100 million tons for the first time; the crop is expected to reach 105 million tons or more, compared with the previous high of 99.5 million in CY 1969. With about 5 million tons of foodgrains already stockpiled for emergencies and with about 1 million tons of fertilizer on hand, India is in a relatively good position to withstand the impact of poor weather. Of all the foodgrains, only the pulses, the major source of protein in the Indian diet, continued to lag far behind population growth. 3/ In contrast with the good performance of foodgrains, commercial crops increased only 2% in 1970, compared with 5-1/2% in CY 1969. Yields of these crops remained low, apparently because some of their irrigated land was switched to the more profitable foodgrains.

4. Industrial production rose less than 5% in 1970 (see Table 1) -- the lowest rate in three years. Increasing labor unrest, raw materials shortages, reduced government investment, and poor management of government-controlled heavy industries – on which many other industries depend – closed some plants in 1970 and reduced many others to producing far below capacity. This slow industrial growth was a severe setback to India's development plans. The Fourth Five-Year Plan (1969-73) called for an industrial growth rate averaging 9% annually. The average for the first two years of the Plan, however, was only about 6%.

5. Some factors contributing to the industrial slowdown also contributed to rapidly rising prices. Prices of industrial raw materials increased by 14-1/2% in 1969 and 9-1/2% in 1970 (see Table 2), reflecting both commercial crop shortfalls and insufficient imports. The prices of manufactured goods, in turn, also registered sharp increases in both years. However, the overall wholesale price index increased only about 5-1/2% in 1970, largely because foodgrain prices actually declined slightly with rising supplies.

6. In an effort to check inflation, New Delhi has held down development spending and has tried, without much success, to curb deficit financing. India's budgetary deficits for the past several years have increased steadily and exceeded 4 billion rupees 4/ in 1970 (see Table 3). The record foodgrain crops have increased incomes, but government revenues have not

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2. *Periods for agriculture are given in crop years, which begin on 1 July of the stated year.*

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4. *Seven and one-half rupees equal US $1.*

Table 2

India: Wholesale Price Indexes, Total and Principal Categories

1961 = 100

Fiscal Year	All Commodities	Foodgrains	Industrial Raw Materials	Manufactures
1961	100.0	100.0	100.0	100.0
1962	103.8	105.4	97.8	102.6
1963	110.2	115.2	100.2	104.8
1964	122.3	145.5	115.9	109.0
1965	131.6	154.3	132.8	118.1
1966	149.9	182.9	158.4	127.5
1967	167.3	228.4	156.4	131.1
1968	165.4	201.0	157.3	132.7
1969	171.6	208.2	180.1	143.5
1970	181.1	206.8	197.3	155.0

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Table 3

India: Consolidated Government Budget

Billion Rupees

	Fiscal Year			
	1967	1968	1969 (Estimate)	1970 (Budget Estimate)
Expenditure, total	64.48	68.27	76.74	79.46
Development	36.76	39.37	44.08	46.97
Nondevelopment	27.72	28.90	32.66	32.49
Revenue, total	61.28	64.56	72.68	75.37
Total current revenue	45.16	49.43	54.05	60.23
Tax revenue	34.55	37.59	40.75	46.04
Income and corporation tax	6.36	6.78	7.20	7.80
Sales tax and excise	16.79	19.19	21.87	25.38
Custom duties	5.13	4.46	4.15	4.65
Land revenue	1.08	1.26	1.16	1.23
Other taxes	5.19	5.90	6.37	6.98
Nontax revenue	10.61	11.84	13.30	14.19
Total capital revenue	16.12	15.13	18.63	15.14
Internal	8.99	10.17	12.21	9.51 a/
External	7.13	4.96	6.42	5.63
Overall deficit b/	*3.20*	*3.71*	*4.06*	*4.09 c/*

a. Including receipts from banking sources.
b. Defined as the increase in the net claims of the banking system on the government in all forms.
c. Understated to the extent that some bank borrowing is included in internal capital revenues.

increased accordingly because of New Delhi's reluctance to tax agricultural income. Taxing agricultural income remains a function of individual states, and state land taxes have been insignificant. More than 50% of the central government's tax revenue comes from excise taxes and custom duties, and in 1970, collections were about one-third below plan. Moreover, total expenditures were well above planned levels essentially because of increased nondevelopment spending by the states which do not have to comply with the central government policy of monetary restraint (see the accompanying tabulation).

Year	State Expenditures (Million Rupees) Plan	Actual	Percent Above Plan
1969	9,530	10,910	14
1970	11,690	12,980	11

States have accumulated excessive overdrafts at the Reserve Bank to finance these expenditures.

7. India's exports increased sharply in 1970 but imports were deliberately held down to conserve foreign exchange and this also retarded industrial production. The trade deficit fell to a record low, and at the end of 1970 India's international financial position -- its potential for financing a payments deficit and thereby boosting imports -- was about $2.5 billion, having increased steadily by about $800 million since 1966. 5/

Sluggish Industrial Production

8. Heavy industry, whose foreign exchange costs were financed largely by foreign aid, had steadily increased capacity during 1955-64 in the expectation that investment in public enterprises would continue to increase rapidly. Since then, however, the leveling off of investment has created considerable excess capacity. The government for domestic budgetary reasons held its investment outlays down and, with public sector demand low, heavy industrial output was slack. Capital goods output continue to stagnate and in 1970 remained below the 1965 level. The output of industrial machinery and railway equipment was particularly hard hit;

5. Including nonproject aid in the pipeline, foreign exchange reserves, and the International Monetary Fund (IMF) quota less drawings (see paragraph 15).

the latest available data indicate that output continued to decline steadily in the first eight months of 1970. The poor performance of the capital and intermediate goods industries is largely explained by the steel shortage. Steel production was particularly depressed as plants, plagued with labor troubles, managerial problems, and technological difficulties, operated at only about 65% of capacity in 1970. Estimated outputs of finished steel and steel ingots in 1970 were 4.6 million tons and 6.1 million tons, respectively, compared with 4.8 million tons and 6.4 million tons in 1969.

9. Sharp production declines in the railway equipment industry in 1970 reflected a slowdown in freight haulage as well as the government's failure to push railway equipment exports. Reduced haulage resulted from sluggish industrial production – reflected principally in markedly reduced haulage of iron, steel, and coal – a reduced railway investment program, and from numerous strikes, extreme operational difficulties, and other disruptions. Freight traffic on the eastern railroads – which account for 60% of all the tonnage carried by the railroad industry – was reduced 50%, principally because of increased lawlessness in troubled West Bengal. Thousands of thefts of telecommunication cable and equipment and numerous attacks on railway property helped reduce total rail traffic 19 million tons during 1970, compared with 1969.

10. New Delhi, responding to pressure from industry to increase public sector spending for capital goods and from states favoring higher local expenditures, planned to increase public sector development expenditures in 1970 by 25%, as compared with 1969. Spending at this level might have helped stimulate industry, but New Delhi's conservative policies remained essentially unchanged – no new tax measures were enacted, little additional revenue was raised, and public sector development spending actually increased only about 12%. Price rises reduced this to a real increase of only about 7%. In any event, government spending in the public sector in 1970 was no higher than in 1968.

11. Although precise data are not available, indications are that private industrial investment increased slowly, if at all, last year. Concerned about the growth and concentration of economic power, New Delhi passed legislation in 1970 sharply restricting activities of the large industrial houses. There was a great deal of confusion surrounding the new procedures. This, along with uncertainties about government intentions in general, curbed private investor interest.

12. A sharp deterioration in labor relations, especially in the industrial state of West Bengal, also had an adverse influence on private investment. 6/

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Table 4

India: Balance of Payments

Million US $

	Fiscal Year			
	1967	1968	1969	1970
Trade balance	-1,147	-735	-206	-166
Exports	1,598	1,810	1,884	2,000 a/
Imports	2,745	2,545	2,090	2,166
Foodgrains	691	449	348	260
Project-tied	380	368	307	325
Fertilizer	298	258	295	332
Other imports b/	1,376	1,470	1,140	1,249
Total debt	-440	-377	-442	-475
Debt services	-455	-478	-550	-590
Debt relief	15	101	108	115
IMF repayments	-8	-98	-148	-252
Other, net c/	-46	105	-53	-55
Overall deficit	*-1,641*	*-1,105*	*-849*	*-948*
Financed by:				
Food aid	447	260	227	132
Other PL 480	76	35	69	43
Project aid	380	368	307	325
Nonproject aid	702	461	490	405
IMF drawings	90	0	0	0
Additions to reserves	54	19	244	-43

a. Based on an estimated 6% increase in exports. India estimates that exports increased more than 8% in 1970 to reach about $2,035 million. In November 1970, however, New Delhi changed its method of computing exports in a way that probably overstates sales abroad.
b. Consisting principally of maintenance imports -- that is, raw materials, spare parts and the like, plus a small amount of capital goods not financed by project-tied aid.
c. Including invisibles, autonomous capital movements, and errors and omissions.

The government reports that man-days lost in industry exceeded 19 million in 1969 and estimates are for about the same level in 1970. Nongovernmental sources, however, suggest that the number may have reached 27 million in 1970. Investment was further restrained because government controls effectively curbed those imports needed to maintain existing industrial production. In addition, investment has lagged in a number of the country's principal industries -- coal, paper, drugs, textiles -- where informal and/or formal price and other controls have kept the industry from recouping increased costs.

Increased International Liquidity

13. India has been steadily improving its international financial position since 1966 (see Table 4). Increased exports, nonfood foreign aid utilizations, and the general decline of nonfood imports are the main reasons for this improvement. The sharp decline in food imports was matched by an almost equivalent decline in food aid, so not much foreign exchange was saved. Capital goods imports, essentially machinery and equipment tied to particular foreign aid projects, fell to a level almost two-thirds below that of the early 1960s. But here also there were no savings in foreign exchange, because project aid was identical with project imports. However, maintenance-type imports (including fertilizer and other nonfood agricultural imports) needed to keep existing capacity in operation and to improve agriculture, declined from $1.7 billion in 1967 to $1.5 billion in 1970. Considerable savings were realized because large-scale nonproject foreign aid (including debt relief and PL 480 nonfood aid) financed an average of 40% of maintenance imports during this period, much higher than in earlier years.

14. During the four years 1967-70 India received less foreign aid (other than food) annually than in the early 1960s. Nevertheless, the country continued utilizing aid at about previous levels -- $900 million to $1 billion annually -- by drawing down some $900 million of the accumulated $3.2 billion in the pipeline.

15. The slow import growth in 1970 and a sharp boost in exports contributed to India's best international liquidity position and the smallest trade deficit in years. The structure of the change in its overall financial position since 1966 is given in the accompanying tabulation.

	Million US $		
	End of Period		
	1966	1970	Change
Exchange reserves	602	976	374
IMF quota	750	940	190
IMF drawings	-425	0	425
Nonproject aid pipeline a/	785	595	-190
Total	*1,712*	*2,511*	*799*

a. Project aid of about $1.7 billion available for imports of capital equipment and machinery, which is strictly tied to specific aid projects and to the donor country, has not been included here because of the lack of flexibility of this type of aid in spurring growth-related imports in the short run.

In May 1971, foreign exchange reserves reached $1 billion. India's IMF quota 7/ was raised by $190 million in 1970 and for the first time since 1956 New Delhi had repaid all drawings outstanding and was free of debt to the Fund.

Increased Exports

16. India's exports increased about 6% in 1970, continuing a three-year upward trend and, with the slow growth of imports, the country's trade deficit fell from its billion dollar level of the early 1960s to less than $200 million. Until recently, Indian manufacturing firms serving the highly protected and relatively large domestic market had little incentive to export. Tight controls on import licenses and pressure on companies to use more local goods further reduced incentives for exporters by increasing production costs. 8/ Efforts have been made in recent years,

7. *The normal limit on the member's use of IMF resources. Under certain conditions, drawings can exceed the quota.*

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however, to boost exports by providing preferential treatment for imports to selected industries, lowering export duties, raising subsidies, giving extensive export credits and guarantees, and providing concessional freight rates.

17. New Delhi's promotional efforts concentrated on increasing sales abroad of engineering goods and newer manufactures rather than on traditional and primary goods. The country's principal exports (jute manufactures, cotton textiles, and tea, which made up about half of India's exports in the early 1960s) have continued to lose ground. Data for the first nine months of calendar year 1970 show that exports of jute manufactures fell 30% in value, cotton textiles 8%, and tea 24%. On the other hand, exports of engineering goods and other newer manufactures have done quite well. Nontraditional manufactured goods exports increased 25% in 1970, iron ore 25%, and fish and fish products 7%.

Policy Options and Short-Term Prospects

18. Barring unfavorable monsoons, India's overall growth rate is likely to average about 5% for the next year or two. As in the past, weather and the policies of the government will largely determine India's economic performance. In the agricultural sector, weather is still the unpredictable factor and, with foodgrain production on the rise, the government is not considering any significant policy changes for that sector. In industry, however, Mrs. Gandhi has several options for accelerating production, including more public spending, liberalizing import restrictions, and encouraging private investors. A higher growth rate in industry, such as the planned rate of 9%, could raise the overall growth rate close to 6%.

19. India's new budget announced in June 1971 -- for the year ending 31 March 1972 – indicated that the government apparently is in no hurry to use its solid Parliamentary majority to embark on expansionary fiscal policies. The budget is essentially conservative, with total spending scheduled to increase by only 4.6%. New taxes were proposed to hold the budget deficit at about its 1970 level. This continuing conservatism in fiscal policy suggests that public sector spending is not likely to accelerate. Apparently the fear of inflation has restrained Mrs. Gandhi from exercising this particular option at this time.

20. Although India continues to follow a strict import substitution policy and has recently even increased the list of banned imports, New Delhi announced in late 1970 that requirements for steel and nonferrous metals – two particularly scarce commodities – will be supplemented by increased imports in 1971. India's currently improved international credit position is sufficient to pay for substantially increased purchases abroad,

and greater supplies would undoubtedly relieve some of the inflationary pressure.

21. It is not clear how far New Delhi intends carrying this modified import liberalization policy. The government is not likely to draw down its foreign exchange reserves too far or to go sharply into debt to the IMF. The 13-nation Aid India Consortium has recommended $1.2 billion in additional foreign aid for 1971 9/ -- compared with less than $1 billion in 1970 – despite India's improved international liquidity position. The Consortium noted that the improved position was bought at the expense of economic growth. Increased foreign aid will help pay for some additional imports under liberalized policies, but the extent of import liberalization ultimately depends on export performance. Export incentives already have been increased for 1971 and time-consuming administrative procedures have been simplified. More industries have been brought under export promotion schemes and import privileges have been linked more closely to export performance. As an exception to general policies, New Delhi is encouraging private foreign collaboration in export industries and is permitting large industrial houses to expand capacity if a certain percentage of production is exported. Last year's sharp increase in exports in the face of lagging production and rising domestic demand attests to the short-term success of the government's export promotion measures.

22. There are indications that private industrial investment may increase in 1971 and provide some of the stimulus the economy needs. Private investors generally have expressed confidence in the stability of Mrs. Ghandhi's government. Import liberalization, especially if it is extended significantly, will provide a further incentive to investors.

Conclusions

23. The slowdown in industrial growth in 1970 marred an otherwise favorable year for India's economy. The 5% increase in national income was well above population growth, and much better than the 3% average growth recorded during the 1960s. The industrial growth rate of about 5%, however, was far short of the 9% targeted for the Fourth Five-Year Plan (1969-73). Investment levels remained low in both the public and private sectors, while labor problems and raw material shortages resulted in widespread unemployment of both labor and capital. On the plus side, foodgrain production continued to increase in 1970. Ironically, the "green

9. Aid for the East Pakistani refugees in India was not included in this proposed aid package.

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revolution" contributed to the industrial slowdown by inducing farmers away from commercial crops – especially cotton – because of the higher government incentives for wheat growing. The resulting domestic shortages of raw materials were not sufficiently offset by increased imports, and prices of manufactured goods rose sharply.

24. There are no indications as yet that industrial production has accelerated in 1971. Private investor confidence, however, apparently has increased, with the prospects for a stable government and the hope for possible relaxation of at least some government controls over private businessmen. Additional incentives already granted to exporters should result in a continuation of the favorable export performance of 1969 and 1970. On the other hand, spending in the public sector – predominantly heavy industry – apparently is being kept low, and will hold down the demand of a host of other industries. The fear of inflation is restraining New Delhi from the expansionary fiscal policies necessary to increase public sector spending.

25. India's highly favorable international financial position provides an opportunity for expanding imports and deliberately widening the trade deficit, at least temporarily. The government, with its general control over imports, could open the gates to more industrial raw materials and other imports required to maintain the industrial sector. Without an expansion of such imports, industry is unlikely to recover rapidly from its current slump.